CAPTIAL MARKET CA 1 FIN-309

On

ROLE OF CAPTIAL MARKET IN THE ECONOMIC DEVELPOMENT

Under the Guidance

of Mr. **ANOOP**

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Abstract:

The study examined the role of capital market on economic development in Nigeria. However, the specific objectives are to ascertain the role played by capital market in developing Nigeria's economy and to discover problem faced by the Nigerian capital market which inhibits economic growth. Majority of data collected from this work were sourced from world bank data group and NSE bulletin which were analyzed using correlation Analysis. The result from this work indicates that the capital market plays a major role in driving the Nigerian economy growth and the Nigerian Public view the capital market as major outlet for savings and investment. In conclusion the capital market has a higher potential which is yet to be realized in Nigeria. Therefore, government should deregulate or liberalize capital market so that market forces should be allowed to determine the stock prices. Keywords: Capital Market, Market Forces, Economic Development

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Introduction:

Capital plays a vital role in the modern productive system. Production without capital is hard for us even to imagine. Nature cannot furnish goods and materials to man unless he has the tools and machinery for mining, farming, forestry, fishing, etc.

If man had to work with his hands on barren soil, productivity would be very low indeed. Even in the primitive stage, man used some tools and implements to assist him in the work of production. Primitive man-made use of elementary tools like bow and arrow for hunting and fishing net for catching fishes.

As we all can see with rise of massive industrialization and production it has become eminent and necessary for organizations to seek out more funding to aid their production, this occurs at a level far higher than what savers and banks can provide. Out of this necessity the capital market was born. The capital market thus provides a medium in which both governments and industry are able to raise long term capital for expanding and modernizing industry as well as providing financing for development projects. The financial market is categorized into two, both the capital market and money market which serve distinct and specialized purpose. The money market is an exchange market where both individuals and governments borrow high quality debt securities with a maturity period of one year. In essence it allows you borrow securities in the short term. Some of the instruments traded in this market include treasury bills, certificates of deposit, commercial paper, federal funds, bills of exchange, and short-term mortgage-backed securities and asset-backed securities. The capital market on the other hand provides debt and equity backed securities for a longer term. In this market, Government issue only bonds mostly in form of treasury bills while companies issue both stocks and bonds. The whole purpose of the capital market is that it enables governments, banks, and other large institutions to sell short-term securities to fund their short-term cash flow needs/ deficits. In the situation of an emerging economy like Nigeria, Okereke- Onizuka (2004) states that the capital market remains the cheapest and most flexible source of financing for the government and companies and remains a critical element in sustainable development of a nation. At the turn of the 21st century the relationship between stock market performance and economic growth has been a subject of debate among major analyst based on their study of developed and emerging markets. Singh (1999) argues that capital market has been unable to function efficiently in developing countries because of the huge cost in maintaining such markets as well as poor financial structure and corporate governance in such nations. In principle, capital markets are expected to accelerate economic growth by providing a huge boost to domestic savings and increasing the quantity and the quality of investment, provide individuals with additional financial instrument that may better meet their risk preferences and liquidity needs (Levine and Zervos, 1998). The capital market in a developing country like Nigeria despite the constant fluctuation is yet to realize its full potential therefore this research intends to investigate the effect the capital market has on the Nigerian economy, its problems and proposed solutions.

Problem identified:

Despite the widely- known benefit of capital market globally, it has been unable to convert an emerging economy like Nigeria into a developed country. As the capital market in Nigeria grows and moves, a lot of problems and reforms have been formulated. For example, second tier securities market were established to remove obstacles which stopped several local indigenous companies seeking quotation to join the market and also to provide wider and cheaper long-term funding for small and medium sized indigenous companies. In spite Role of Capital Market on Economic Development in Nigeria, this makes us to ask certain questions. i. Why has the Nigerian capital market with its huge population been unable to make Nigerian economy into a developed one 2) despite an establishment of a second-tier securities market why are Nigerian companies reluctant to join the stock exchange? ii. Despite improvement in the activities of the capital market, why is the Nigerian economy heavily dependent on the money market. Objectives of the Study This study is designed to examine the role of the Nigerian capital market on economic development.

Stock Market Development and Economic Growth:

STOCK MARKET DEVELOPMENT AND ECONOMIC GROWTH

Stock Market Development Measures	Rank Correlation	Rank Brazil
Number of stocks	.412	3
Market capitalization	.341	4
Value traded	.335	5
Turnover ratio	.203	5
Market capitalization/GDP	.249	13
Value traded /GDP	.360	8

Capital Market:

Capital markets are a general category of markets that facilitate the buying and selling of securities with medium-term and long-term maturity, of one year or more. Capital markets channel savings and investment between suppliers of capital and users of capital through intermediaries. Examples of these key players in the capital market's process are:

Suppliers of Capital:

Also known as surplus units, suppliers receive more money than they spend or have immediate use for. They can be termed as investors. They provide their net savings to the financial markets for a return on the capital provided. Examples include retail investors and institutional investors,

Financial Intermediaries:

A financial intermediary is an institution or individual that serves as a middleman among diverse parties in order to facilitate financial transactions. Common types include commercial banks, investment banks, stockbrokers, fund managers, and stock exchanges,
Users of Capital: Also known as deficit units, users of capital spend more money than they receive or need funds for investments or development. They are also termed as borrowers. They access funds from the capital markets. Examples include businesses, the government and individuals.

Challenges of Developing Capital Markets

Economic growth in a modern economy hinges on an efficient and effective financial sector that pools domestic savings and mobilizes capital for productive projects. The absence of effective capital markets could leave most productive projects that carry developmental agendas unexploited. However, there are challenges in developing capital markets as they are to a large extent dependent on the level of economic and structural development of a country. Factors affecting the development of capital markets include;

Country Fundamentals:

The size of the economy in terms of aggregate gross domestic product and per capita income affect the development of capital markets. This explains in large part why, in general, capital markets are at an embryonic stage in smaller and low-income countries, while more developed countries have more robust capital markets. This can be explained as more developed economies have greater institutional development, a larger institutional investor base, higher levels of contractual savings such as pension funds, political stability and macroeconomic stability.

Macroeconomic Policies Framework:

An essential condition for well-functioning capital markets is the existence of sound macroeconomic policy frameworks. Capital markets depend on investor confidence. Strong institutions thrive in stable macroeconomic conditions and investors can also be confident that their capital will not be eroded by factors such as hyper-inflation and exchange rate risks when there is a strong macroeconomic framework in place.

Access to Information:

Access to information is a major factor that affects the development of capital markets. Access to information gives investors' confidence in the functioning of the capital markets. Access to information and transparency allows for the monitoring of users of funds, which increases investor confidence.
Regulatory Framework: To reliably extract the benefits of well-functioning markets, adequate regulation of users of funds, investors, and intermediaries in addition to robust supervisory arrangements to protect investors, promote deep and liquid markets, and manage systemic risk are critical.

Efficient Market Infrastructure:

Lack of adequate and efficient market infrastructure for issuing, trading, clearing and settlement is a major issue for capital market development as it pushes away potential investors to an economy.

Knowledge of Retail Investors:

The lack of investor education for retail investors is another factor affecting the development of capital markets. It is important to educate retail investors on investment products and the benefits of saving, in order to channel savings to the capital markets

Economic Growth:

GLOBAL MARKET INTEGRATION AND ECONOMIC GROWTH

Global Market Integration Measures	Rank Correlation	Rank Brazil
OPEN I	-.241	7
OPEN II	.235	8
OPEN III	.310	1
POLRI	.591	13
INFLAT	.777	18
CORREL	.393	10

Brief History of Nigerian capital market:

Nwankwo (1991) clarified that the history of the Nigeria Capital Market dates to the late 1950s when the Federal Government formed the Barback Committee through its Ministry of Industries to advise on ways and means of setting up a stock market. Prior to independence, Nigeria's financial operators consisted mainly of foreign-owned commercial banks that issued short-term commercial loans to Nigerian-based overseas companies which their capital balances invested abroad in the London Stock Exchange. Based on the report of the Barback Committee the Lagos Stock Exchange was established.

Emerging Stock Market:

EMERGING STOCK MARKETS—INSTITUTIONAL INDICATORS

Country	(1) Regular Publication of P/E Yield	(2) Accounting Standards	(3) Investor Protection	(4) Securities Commission	(5) Restrictions			(6) Withholding Tax Rate	
					Dividend	Capital	Entry	Capital Gains	Dividend
Latin America									
Argentina	0	1	1	1	0	0	0	36%	17.5%
Brazil	1	2	2	1	0	0	0	25	25
Chile	1	2	2	1	0	1	0	10	10
Colombia	0	1	1	1	1	0	0	30	0
Mexico	1	2	2	1	0	0	0	0	0
Venezuela	0	1	1	1	1	1	0	0	20
Asia									
India	1	2	2	1	1	1	1	40	25
Indonesia	1	0	1	1	1	1	0	20	20
Malaysia	1	2	2	0	0	0	0	0	0
Pakistan	0	1	1	1	0	0	0	0	15
South Korea	1	2	2	1	0	0	1	0	25
Thailand	1	1	1	1	0	0	0	25	20
Europe/Mideast/Africa									
Greece	1	0	0	0	1	1	0	0	42
Jordan	0	0	1	1	0	0	0	0	0
Nigeria	0	1	1	1	1	1	2	20	15
Portugal	1	1	1	1	0	0	0	0	25
Turkey	1	1	0	1	0	0	0	0	0
Zimbabwe	0	1	1	1	1	1	1	30	20

Objectives of the Study:

This study is designed to examine the role of the Nigerian capital market on economic development. I have
chosen this topic to create general awareness among different sector of the economy how the Nigerian capital
market can be of help to them. Therefore, this study aims to:

i. To understand the role-played by capital market in developing Nigeria's economy.

ii. To discover problem faced by the Nigerian capital market that inhibits economic growth

Research Hypotheses:

For this research we will conduct the null hypothesis against the alternative hypothesis, wherein the alternate hypothesis holds the negative decision to the null.

Ho1: There is no relationship between stock market capitalization and economic growth.

Ho2: Nigerian public do not view capital market as a good platform for savings and investment

Rationales for establishment of capital market in Nigeria:

Some rationales for establishment of the Nigerian Stock exchange includes

i. It mobilizes savings from surplus economic units to channel them into units of deficit for industrial and economic development purposes. The capital market plays an important role in fostering the socioeconomic development of a country by performing those functions.

ii. Ensures, through its allocation process, an efficient and effective distribution of scarce financial resources in the form of increased productive activities, more employment opportunities, and general improvement of the wellbeing of the people.

iii. It creates an avenue for the Nigerian population to participate in the corporate sector of the economy and share in its wealth.

iv. It reduces the overreliance of the corporate sector on money market in order to raise funds for long-term projects.

v. It helps provide seed money for startup development which can serve as a vehicle for industrial development.

Methodology:

In this section, we will re-introduce our research objectives and hypothesis and display clear cut methods we employed in arriving to our conclusion. Therefore, our data analysis and result will be presented in this section. As proposed in chapter 1, the research work contains 2 hypotheses. The first one will be answered using linear regression analysis done between market capitalization and GDP (2010-2019). The second hypothesis will be answered after offering some questionnaires and deriving some data from them which will then be analyzed using Chi- square. From the result of the analysis will we be able to present clear-cut solutions for research

Overview of Data Collection:

As stated in our research methodology to answer our first hypothesis, data will be collected from world bank data group and NSE bulletin which shows both market capitalization and GDP which will then be regressed to show correlation. The data collected are shown in table below.

Relationship Between Capitalization & GDP		
	X Variable	Y Variable
Date	Market Capitalization (Billions Of USS)	GDP (Billions Of USS)
31/12/10	9,918.21	36,335,988.62
31/12/11	10,275.34	41,033,457.92
31/12/12	14,800.94	4,537,604.98
31/12/13	19,077.42	51,496,628.73
31/12/14	16,875.10	56,849,893.76
31/12/18	21,904.04	39,726,961.61

Our second hypothesis will be answered from our questionnaire to the Nigerian public which asks “Does the Nigerian public view capital market as a good platform for savings and investments?”. Our questionnaire pulled the following data.

Respondent	Yes	No	Total
Traders	15	10	25
Students	13	12	25
Housewives	10	15	25
Businessman	20	5	25
TOTAL	58	42	100

From the above table, we can see that out of the sample of 100 persons. 58 people were in favor of capital market as a good platform for saving and investments. Since majority of the respondents in the sample answered yes to the question one can therefore say that Nigerian capital market is a good platform for savings and investments.

Analysis of Data:

The data analysis section shows us the way our data were analyzed to bring answers for

31/12/15	17,003.39	49,458,318.08
31/12/16	16,185.73	40,464,952.75
31/12/17	21,128.90	37,574,548.65

our hypothesis. With statistical packages on excel Regression analysis was used to answer our first hypothesis. This study will adopt basically the technique of linear regressions, the coefficient of determination of R^2 , the standard error test t, as well as the f-test to determine the extent to which the independent variable affects the dependent variable. The regression estimate will be carried out and the result at 5 percent level of significance.

From Our Analysis we can draw some important information, which are:

R = 0.21

Slope = 739.72

Intercept = 27,623,796.79

From this figure we can draw out certain meaning.

Our R which represents correlation, we can see that there is a correlation of 0.21 between market capitalization and GDP this means that there is a very poor relationship between market capitalization and GDP in Nigeria between 2010 and 2018. From this we can conclude that a change in market capitalization only has a little effect on the Nigerian GDP Which means they do not go hand in hand. Slope interprets that for every unit increase in market capitalization, GDP increases by N739 MILLION and Intercept Tells us that if market capitalization was 0, Nigerian GDP would be 27 million.

Secondly from the questions gathered from our questionnaires we can form some certain conclusion.

We can see that a little above average number of 58 people view the capital market as an avenue for savings and investments. Our Third hypothetical question which was directed to the expert group brought back a result of 115 people out of 150 who accept that the Nigerian capital market mobilizes adequate funds for economic development.

Test of Hypothesis:

The data from answer or responses to the questions are presented and analyzed here. The result of our first hypothetical question can be answered from our linear regression results.

Hypothesis One:

Ho: There is no relationship between stock market capitalization and economic growth
H1: There is a relationship between stock market capitalization and economic growth
From our data analysis section, we can see that t Our R which represent correlation, we can see that there is a
correlation of 0.21 between market capitalization and GDP this means that there is a very poor relationship
between market capitalization and GDP in Nigeria between 2010 and 2018.
The F-test conducted shows that observed is greater than f-critical (2.306) at 5% level of significance. This shows that there is overall
statistical significance in the linear relationship exists between the dependent variable and independent variable.
Also, T test for GDP show that T-observed (5.74) is greater than t-critical (2.86). at 5% level of significance with
two tailed tests, this means market capitalization is statistically significant in explaining GDP which means we
reject the null hypothesis.
Our subsequent hypothesis question is tested using the chi-square
The Formula goes below
X2 = (fo-fe)^2 / fe
Where fo = Observed frequencies
fe = Expected frequencies
To compute the expected frequency hence
Eij = Ti-row * Tj-column / N Table grand total
Where Eij = Expected Frequency
Ti-row = Total Row frequency
Tj -column = Total column frequency
Then reject null hypothesis if x^2 is greater than degree of freedom
Degree of Freedom: Df = (Row-1)(Column-1)

Hypothesis Two:

Ho: Nigerian Public do not view capital market as a good avenue for investment
H2: Nigerian Public view capital market as a good avenue for investment.

Respondent	Yes	No	Total
Traders	15	10	25
Students	13	12	25
Housewives	10	15	25
Businessman	20	5	25
TOTAL	58	42	100

Fo	Fe	Fo - Fe	(Fo – Fe) ^2	(Fo – Fe) ^2/Fe
15	14.5	0.5	0.25	0.02
13	14.5	- 1.5	2.25	0.16
10	14.5	- 4.5	20.25	1.40
20	14.5	5.5	30.25	2.09
12	14.5	- 2.5	6.25	0.43
10	10.5	- 0.5	0.25	0.02

Discussion of Findings:

From our two-hypothesis combined. We can see that the capital market plays a role in the Nigerian economy. However, it is not the major driver of the economy as the answer to the first hypothesis question suggests. That is the correlation of 0.2 which is weak. Secondly the Nigerian public is aware of the capital market however only a little over 50% of those who answered our questionnaire view it as a major source for savings and investment. Therefore, this leaves a very large gap of unutilized potentials of the capital market in the country. Finally, most experts very well agree that the capital market in Nigeria can mobilize enough funds from citizens for economic development. However, from our first question we can see that there is a gap of investment potential in the capital market who do not invest funds in the market.

Case Study - Capital Markets in South Africa, & Learnings for Kenya

According to the Africa Financial Markets Index 2018, by Absa Group, while most capital markets in African countries are relatively underdeveloped, those countries which introduced reforms that are geared towards development of capital markets have been able to grow at relatively higher and sustainable rates. The Africa Financial Markets Index tracks progress on financial market developments of selected African countries annually across a range of indicators. These indicators are; (i) market depth, (ii) access to foreign exchange, (iii) tax and regulatory environment, (iv) market transparency, (v) capacity of local investors, (vi) macroeconomic opportunity, and (vii) legality and enforceability of standard financial markets master agreements. According to the first report published in 2017 and the subsequent report in 2018, South Africa ranked first in both occasions as the most developed financial market in Africa, hence the reason we have picked it as a case study.

A summary of rankings from the report is highlighted in the table below, where the higher the score the more developed the capital markets are based on the indicators above:

ABSA Africa Financial Markets Index

ABSA Africa Financial Markets Index			
2017		2018	
Country	**Aggregate Score**	**Country**	**Aggregate Score**
South Africa	92	South Africa	93
Mauritius	66	Botswana	65
Botswana	65	Kenya	65
Namibia	62	Mauritius	62
Kenya	59	Nigeria	61

According to the African Capital Markets Watch 2018 report by PWC, South Africa again ranks as the most active capital market on the continent. This is supported by a strong financial market's infrastructure and robust legal and regulatory frameworks. The South African capital markets consists of:

Equities:

The Johannesburg Stock Exchange (JSE) is the largest exchange in Africa with over 400 listed firms and a market capitalization of USD 13.7 tn,

Bonds: The South African-listed bond market is estimated to be ZAR 2.7 tn (USD 186.4 bn). It is largely dominated by bonds issued by National Treasury, which account for 68.4% of the outstanding debt, followed by bonds issued by the financial sector (16.0%) and state-owned entities [parastatals] (11.2%). In terms of turnover, the monthly average amount traded on the JSE is ZAR 2.3 tn (USD 158.8 bn),

Derivatives:

Derivatives are traded in exchanges under the umbrella of the JSE, and over the counter (OTC). Exchange-traded products are standardized, and free of counterparty risk. The JSE permits trading in equity, commodity (mainly agricultural), currency, and interest rate derivatives,

Real Estate:

South Africa has the largest and most established REITs market in Africa. The South African listed property sector has a market capitalization of approximately ZAR 380.0 bn (USD 26.2 bn) at the end of 2016, which is 6.4%

of GDP.

South Africa continues to lead capital markets in Africa, supported by a strong financial market's infrastructure and a robust legal framework. South Africa has developed its capital markets

Establishing Progressive Policies:

South Africa has established progressive policies that support the development of financial markets such as the 'twin peaks' strategy for improving financial regulation, which separates regulatory functions between a regulator that performs prudential supervision and one that performs market conduct supervision. This separation clearly defines the objectives and mandates of the respective agencies and separates the role of regulator and promoter.

Promoting Investor Education and Financial Inclusion:

South Africa has also introduced frameworks to increase financial literacy with South Africa's newly-created Financial Sector Conduct Authority established to supervise financial markets and promote financial education. Its consumer education department holds workshops on financial literacy and investor education, particularly in rural areas and among groups that have been excluded from financial services.

Adopting Standardized International Markets

Framework:

South Africa also uses international markets and standardized frameworks to develop its capital markets such as the Master Agreement of the International Swaps and Derivatives Association, the Global Master Repurchase Agreement and the Global Master Securities Lending Agreement, which helps the country to be more prepared to drive product innovation and growth in the derivatives market and open up its capital markets to international investors.

Using Technological Innovation:

South Africa also makes use of technological innovation to make its capital markets more efficient. For example, the South African Reserve Bank has set up an electronic trading platform for primary dealers in an effort to improve liquidity and transparency in the government bond market. There are plans to expand this to other market participants and for other securities, including corporate bonds.

Due to the efficiency of the South African capital markets, businesses have credible alternative sources of funding and they do not have to over-rely on banks in S outh Africa to have access to capital markets funding. This makes South Africa an attractive destination for businesses, including multinationals to set up operations.

Steps Kenya Should Take to Expand its Capital Markets

as Complementary to Bank Funding:

We look at what Kenya can learn from South Africa as South Africa has the most robust capital markets in Africa. In our view, Kenya should adopt the following recommendations that will address the existing bank dominance, reduce the funding reliance we have on banks, and support the expansion of capital markets as an alternative to banks:

Focus Legislation and Policies to Stimulating the Capital Markets and Alternative Products, as Opposed to Focusing Mainly on Banks:

A lot of legislative action has focused on the banks, yet we also need legislation to promote competing products that will diversify funding sources, which will enable borrowers to tap into alternative avenues of funding that are more flexible and pocket-friendly. This can be done through the promotion of initiatives for competing and alternative products and channels. In developed economies, 40% of business funding comes from the banking sector, with 60% coming from non-bank institutional funding such as capital markets and alternative sources. However, in Kenya, 95% of all funding is bank funding, and only 5% from non-bank institutional funding, showing that the economy is highly dominated by the banking sector and should have more capital market products for funding businesses. Not to mention that cost of bank funding is too high. To try and address cost of funding and access to funding, the legislation has focused on the wrong issues such as legislating cost of borrowing and trying to allocate a certain amount of loans to SMEs. Our view is that legislation ought to be more focused on creating a more supportive environment to capital markets and alternative funding,

Summary of Major Findings:

From our data analysis results, we can draw a very sound conclusion that despite capital market
holding a very optimistic and critical role in development of Nigerian economy there is a lot of gaps to be filled.
Our first hypothesis shows a correlation between Market capitalization and GDP to be low, although statistically
significant, it means there's a major major gap to be filled by the Nigerian capital market in driving the Nigerian
economy.
Our second and third hypothesis shows that majority of people answered yes for the (2) questions
posed " Does the Nigerian Public view the capital market as a good platform for savings and investment" and
secondly does the Nigerian capital market mobilize adequate funds from citizens for economic development.
This means that there is a visible awareness of the potential of the capital market both among experts and

citizens but more money needs to be channeled into the Nigerian capital market to aids its growth and in turn
propel the Nigerian GDP.

Conclusion:

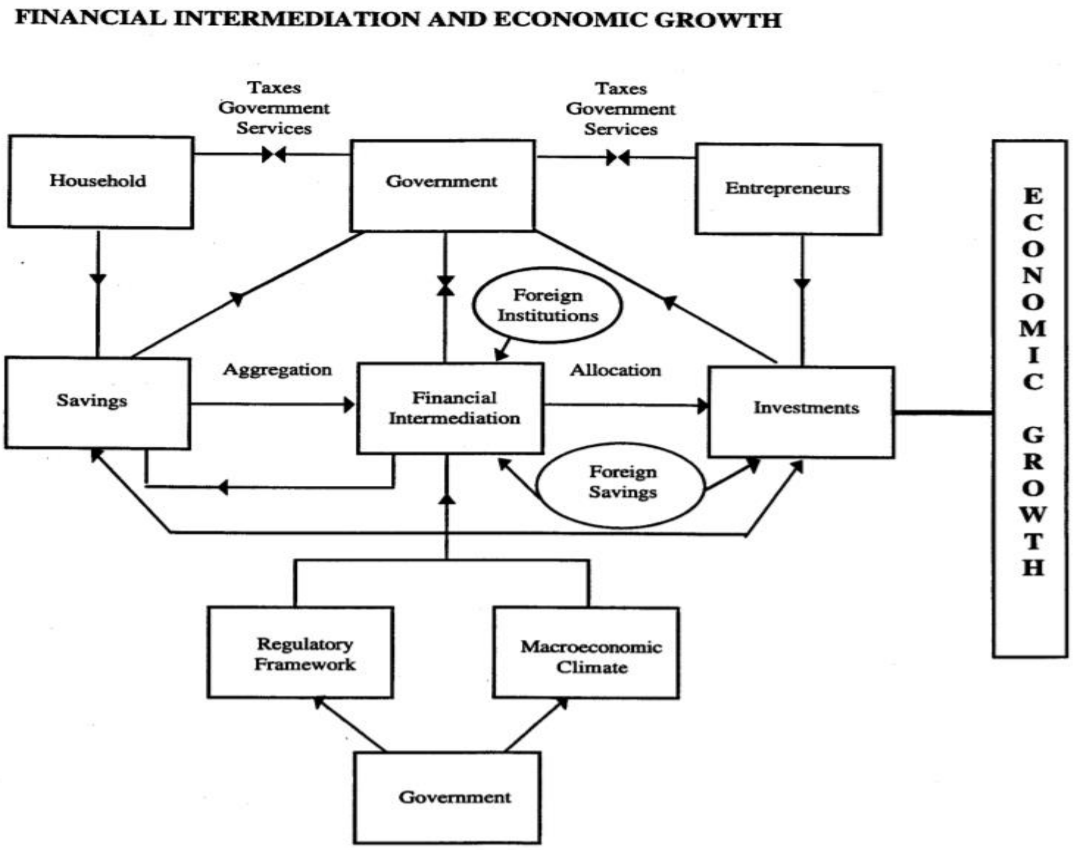
From the results of our findings, we can see that the capital market though important is still
underutilized in the Nigerian economy. The data analysis and the result from these chapter points out this
important information. Thereby telling the researcher that there is a gap that needs to be filled to utilize the
capital market.
From our research results we can conclude that The Nigerian capital market plays an effective role in
the economic development of Nigeria. However, gaps can still be found in areas of market liquidity and turnover
due to low number of investors and investments. Also, there is a buy hold syndrome prevalent in the Nigerian
society which causes stagnation in the market. In conclusion the capital market has a huge potential which is yet
to be realized in Nigeria, therefore with implementation of some solutions the market growth could be
enormous.

Recommendation:

Bearing in mind, the important difficulties facing the Nigerian capital market, especially in areas of capital accumulation and enlightenment of the masses. Some of the recommendations I would offer based on this research work are as follows: Mass education of Nigerians about the Nigerian capital market, it's purposes and its functions is required. The Government should introduce a policy that will make it necessary for graduates to learn about the stock market at their final year in school and collaborate with SEC and NSE to engage in mass enlightenment of the mass in public life. The government should deregulate or liberalize capital market so that market forces should be allowed to determine the stock prices. The SEC and CBN should collaborate to internationalize the capital market in Nigeria and to create a suitable investment avenue so that foreigners will readily invest in the market. It has also been noted that Nigerians in general have a Buy hold syndrome therefore I suggest that the Nigerian stock exchange (NSE) should sponsor research on the "Buy and Hold" securities attitudes of many Nigerians, to find out all the causes and how they can be tackled, Also organize seminar in this direction for all shareholders educating them on how to transact the business of

securities. Finally, the Nigerian Govt must increase its surveillance on the Nigerian stock market because a lot of malpractices has been recorded in the past which has led to reluctance of investors to invest in the market.

Therefore, the corporate governance and ethics should be revised.



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Thank

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